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In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1291

ROBERT B. BRUCE, PETITIONER

v.

UNITED STATES OF AMERICA

No. 73-1558

ROBERT S. WALKER, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

After a jury-waived trial in the United States District Court for the Northern District of Georgia, petitioners were convicted of mail fraud in connection with sales of certain securities, in violation of 15 U.S.C. 77q(a) and 18 U.S.C. 1341, and of conspiracy to commit such fraud, in violation of 18 U.S.C. 371. Petitioner Walker was also convicted of fraud in the offer and sale of securities, in violation of 15 U.S.C.

77q(a). Petitioner Bruce was sentenced to concurrent terms of two years' imprisonment, six months to be served in jail with the balance suspended. Petitioner Walker was sentenced to concurrent terms of three years' imprisonment, The court of appeals affirmed (Pet. App. A1-A17)[1] and denied rehearing (Pet. App. A18).[2]

Petitioners' indictment and convictions were based upon the operations of American Capital Corporation, incorporated by petitioner Walker on December 13, 1966, which engaged in two offerings of securities, the first commencing in January 1967, and the second in April 1968. Petitioner Walker was president of the corporation; co-defendant Blackwood provided various legal services to the company; petitioner Bruce, a certified public accountant, was retained to provide the financial statements that were included in two prospectuses relating to the corporation's securities offerings.[3]

The corporation offered two types of securities: common stock and interest-bearing investment certificates. The ostensible purpose of the corporation was to provide loans to smaller, growing companies, and to improve upon the

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[1]"Pet. App." refers to the appendix to Bruce's petition (No. 73-1291).

[2]Co-defendant Robert A. Blackwood was also convicted on similar charges. His conviction was affirmed, except that one count charging sale of unregistered securities, in violation of 15 U.S.C. 77e(a), was reversed (Pet. App. A16).

[3]The Georgia Securities Commission had in the early part of 1968 forbidden American to engage in further sales until a second prospectus was filed. American ceased doing business in May 1969.

mutual fund concept by promising a six percent return on the investment certificates. In fact, the trial court found that, although the corporation acquired some $200,000 from the sale of its securities, it did not endeavor to engage in the type of investment promised in the prospectuses and that it contemporaneously wasted large sums on the personal comforts of the officers, particularly petitioner Walker and Blackwood (Pet. App. A20-A21).[4]

Petitioner Walker, who, as president of the corporation, directed its operations, was adjudged guilty on fraud counts arising from both the first and second offerings, the trial court holding that he had acted in bad faith from the incipiency of the coporation's existence. The court entertained a reasonable doubt as to whether petitioner Bruce and co-defendant Blackwood had initially participated in the corporation's operation in bad faith, and accordingly found them not guilty of the charges arising from the first prospectus and offering. As to the second prospectus and offering, the court found them both guilty because, along with petitioner Walker, they "knew and could not have failed to know that the business they were conducting was a fraud" (Pet. App. A21-A22).

In addition to its general finding that American, under petitioner Walker's direction, had not sought to engage in the investment plan envisioned by the prospectuses, the trial court also determined that the two prospectuses contained a variety of financial compilations and statements which "if not flagrantly false, are patently mislead-

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[4]An SEC accountant testified that, from his examination of its records, the corporation had never received any identifiable income from any source (Tr. V 58-59).

ing and deliberately fraudulent" (Pet. App. A22). These misleading representations in the two prospectuses consisted of the following:[5]

(a) When American was first incorporated, it acquired certain Florida land (Ridge Manor) by issuing 35,000 shares of common stock and incurring obligations amounting to $380,000, which land both the first and second prospectuses listed as having a value of $1,076,600. In fact, the claimed value of Ridge Manor was an estimated value of the property after subdivision and development, which had not yet begun and which American had not the funds to initiate. Similarly, the first prospectus failed to mention that the mortgage on the Ridge Manor land that American had purchased was overdue at the time of purchase. The second prospectus admitted in a footnote that the land had subsequently been foreclosed, but it stated that American had an option to redeem the property by June 10, 1968, upon payment of approximately $300,000 of the mortgages. This transaction, the statement indicated, would provide an equity of $775,000 and a net worth of $897,000; in fact, the company had no hopes of raising the $300,000 necessary for redemption.

(b) The first prospectus stated that the sales costs of the offered securities would not exceed 4 percent for the certificates and 15 percent for the stock. In fact, salesmen received 20 percent and 33 1/3 percent, respectively.

(c) The first prospectus listed under assets a note receivable for $20,000, which a later footnote states

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[5]We are lodging with the Clerk the court of appeals appendix, which contains copies of both the first and second prospectuses (pp. 85, *et. seq.*).

was due from an officer (Blackwood) on December 8, 1967, and bore interest of 6 percent per annum. The footnote further stated that the only security for the note was 40,000 shares of American. In fact, the note contained on the back a stipulation that it could only be satisfied from the 40,000 shares and did not represent a general indebtedness on the part of Blackwood.

(d) In the second prospectus, under assets, cash at hand was listed as $42,809.35. Hidden in a general footnote several pages later, however, was the statement that a $40,000 bank loan was secured by collateral of unspecified value, consisting of a restricted savings account at the lender bank, and that that savings account had been used to pay off the loan after the date of the accountant's financial statement appearing in the prospectus. Another $2,000 had recently been committed, by a check still outstanding, as a down payment for an airplane. Thus, the actual cash assets should have been listed as $809.35. In addition, the liability incurred for the airplane purchase was not listed under liabilities.

(e) Also listed under assets in the second prospectus was an entry for "Investment in wholly-owned subsidiary, at cost," which was given a value of $77,659.28. A later footnote explained that American had acquired the assets of Babee-Tenda Safety Products, a company that had been adjudicated bankrupt, in return for 26,388 shares of American ($0.10 par value) and the assumption of $75,020 of notes payable by Babee-Tenda. The footnote further explained that American planned to build a new plant for the newly acquired subsidiary, that the "unaudited" sales of Babee-Tenda had been $2,000,000 per year, and that the "unaudited" net worth of Babee-Tenda was some $289,000, thus resulting in an appreciation in book value to American of $211,000. The district court found, however, that this $77,000 "asset" was in fact of questionable actual worth

• because American at the time had no reasonable hope of securing enough capital to revitalize the subsidiary (Pet. App. A22-A23).

(f) The second prospectus indicated that the total amount paid in salaries to company officers did not exceed $16,000. But, while listing a variety of expenses under "Comparative Statement of Income and Expenses,"[6] the prospectus failed to disclose that, of those expenses, petitioner Walker had received some $47,000 worth of benefits in the form of payments of personal automobile loans, other personal loans, apartment rental, etc. In total, petitioners and Blackwood received approximately $60,000, or 20 percent of the capital received by the corporation.

(g) Although the company was in dire financial condition by the time of the second prospectus, that document sought to induce false confidence in the company by placing a notice on the first page stating that the interest yield on investment certificates had been raised from six to seven percent.

That petitioners did not participate in American's operation and sales in good faith was highlighted in a facetiously suggested footnote that petitioner Bruce, the C.P.A., forwarded to Blackwood (Pet. App. A23):

> The current deficit of the company was due largely in part to mismanagement by the President, the Board of Directors, the Executive Committee, corporate counsel, the Securities and Exchange Commission, the Georgia Securities Commission, the F.B.I., the Governor Lester Maddox. In addition, all of the boobs that didn't waste their money by investing into this fraudulent enterprise actually did not enhance the prospects for defalcations. Management and other

[6]This included approximately $131,000 for 1967.

> idiots always expect a C.P.A. to juggle figures to present miraculous conditions which do not exist. With this particular insolvent, almost bankrupt bunch of frauds, the C.P.A. is presenting the truth, the whole truth, and nothing but the truth, even if he has to lie to do it.

1. Both petitioners argue that the court of appeals applied an incorrect legal standard in determining whether the evidence supported the district court's findings of fraud. Petitioners also contend that the courts of appeals improperly held that one who offers the securities of a financially-troubled business will be deemed criminally liable for fraud should the enterprise fail.

Contrary to petitioners' suggestion, the court of appeals did not establish an overly broad or novel definition of fraud, predicated only upon a standard of "moral uprightness." Rather, after referring to the language quoted by petitioners, the court adhered to the traditional principle that, in a fraud prosecution under Sections 1341 or 77q(a), the government must demonstrate "a scheme reasonably calculated to deceive persons of ordinary prudence and comprehension" (Pet. App. A12). This is a test of long-standing application. See *Silverman* v. *United States*, 213 F. 2d 405, 407 (C.A. 5), certiorari denied, 348 U.S. 828; *Gusow* v. *United States*, 347 F. 2d 755, 756 (C.A. 10), certiorari denied, 382 U.S. 906; *United States* v. *Lichota*, 351 F. 2d 81, 89 (C.A. 6), certiorari denied, 382 U.S. 1027; *Lustiger* v. *United States*, 386 F. 2d 132, 138 (C.A. 9), certiorari denied, 390 U.S. 951.[7]

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[7]In full, the court discussed the issue of fraud as follows (Pet. App. A12):

> Essentially, a scheme to defraud is measured by a nontechnical standard. "It is a reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the

In petitioners' case, although the prospectuses did indicate that the corporation had a deficit net worth, the various financial statements in the prospectuses were unquestionably designed to deceive the ordinarily prudent individual into believing that the corporation possessed a potential for profit, when in fact petitioners and Blackwood recognized that the business would not succeed. As the district court found, the representations were, "if not flagrantly false,* * * [then] patently misleading and deliberately fraudulent" (Pet. App. A22).

For example, while the second prospectus mentioned that Babee-Tenda was acquired out of bankruptcy, it was listed as having a net worth of $289,000 and sales of $2,000,000 per year, when in fact the corporation was no longer an on-going operation, and American had no reasonable financial prospects for its revitalization. Nor did the prospectus mention, in a listing of corporate expenses, that twenty percent of the capital previously acquired had been channeled into personal benefits for the company officers. The value of the Ridge Manor property was inflated to reflect its value when subdivided; similarly, while foreclosure on the Ridge Manor property was revealed, the prospectus, by suggesting an option to redeem when no funds to do so were available, incorrectly represented that the corporation would be solvent once the too highly-valued

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general and business life of members of society", *Gregory* v. *United States*, 5 Cir., 1958, 253 F. 2d 104, 109.

The scheme need not be fraudulent upon its face or misrepresent any material fact. All that is necessary is that it be a scheme reasonably calculated to *deceive* persons of ordinary prudence and comprehension. The intent of the crime is shown by the scheme itself—here, the active promotion of a company known to be inescapably insolvent by making impossible representations of possible wealth to potential investors * * *.

property was reacquired. Finally, to list cash assets at in excess of some $43,000 and to obliquely indicate in a footnote that $40,000 of that amount represented proceeds of a loan which had already been repaid, can only be deemed an attempt to mislead.

Petitioners thus err in characterizing the holding below as imposing potential criminal liability on anyone who offers securities in a financially-troubled enterprise. The court of appeals found criminal responsibility based on a finding that petitioners and Blackwood " 'knew and could not have failed to know that the business they were conducting was a fraud' " (Pet. App. A11) in which none of the company's funds obtained through securities sales had been invested for the purposes stated.[8]

2. Petitioner Walker also argues that he was improperly subjected to double punishment by his conviction on counts Two and Twelve of the indictment, which involved the transaction in which both a letter and a stock certificate for three hundred shares of American were mailed to a purchaser on November 3, 1967. Count Two charged a violation of 15 U.S.C. 77q(a), while Count Twelve

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[8]Petitioner Walker's reliance (Pet. 9-10) upon *Bronston* v. *United States*, 409 U.S. 352, is misplaced. That case involved the question whether a literally true but unresponsive and misleading answer to a question posed during cross-examination of a witness constituted perjury, in violation of 18 U.S.C. 1621. As this Court noted, the witness's answer in *Bronston* was "not to be measured by the same standards applicable to criminally fraudulent * * * statements. In that context the law goes 'rather far in punishing intentional creation of false impressions by a selection of literally true representations, because the actor himself generally selects and arranges the representations.' " 409 U.S. at 358, n. 4.

alleged a violation of 18 U.S.C. 1341.[9] We note ini-

[9]The exact wording of the two counts, not accurately reproduced in Walker's petition (pp. 12-13), are as follows:

> *Count Two:* 1. The grand Jury realleges all of the allegations contained in paragraphs 1 to 18, inclusive, of Count One of this indictment.
>
> 2. On or about November 3, 1967, the defendants and West did willfully and unlawfully, in the offer and sale of a security, namely, the common stock of American Capital Corporation, by use of the mails, employ the aforesaid scheme and artifice to defraud, obtain money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and engage in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of said securities, including Thomas D. Wyatt, said use of the mails being as follows: On or about November 3, 1967, in the Northern District of Georgia, the defendants and West willfully caused a letter dated November 3, 1967, enclosing a stock certificate of American Capital Corporation, to be delivered by the Post Office Department to Thomas D. Wyatt, 512 Fairground Street, Apt. B, Marietta, Georgia 30060; in violation of Section 77q(a), Title 15, U.S. Code.
>
> *Count Twelve:* 1. The Grand Jury realleges all of the allegations contained in paragraphs 1 to 18, inclusive, of Count One of this indictment as constituting and describing a scheme and artifice which the defendants and West devised and intended to devise to defraud and to obtain money and property by means of false and fraudulent pretenses, representations and promises.
>
> 2. On or about November 3, 1967, in the Northern District of Georgia, the defendants for the purpose of executing the aforesaid scheme and artifice to defraud and attempting to do so, unlawfully, willfully and knowingly caused to be delivered by U.S. Mail according to the direction thereon an envelope and contents addressed to Mr. Thomas D. Wyatt, 512 Fairground Street, Apartment B, Marietta, Georgia, 30060, said contents consisting of a letter on American Capital Corporation *stationery dated November 3, 1967 and signed Robert F. Walker, President, and a stock certificate for 300 shares of stock in American Capital Corporation;* in violation of Section 1341, Title 18 U.S. Code. [Emphasis supplied.]

The emphasized portion was omitted through an apparent printing error.

tially that there is no need for the Court to address this issue, as petitioner received concurrent sentences on Counts Two and Twelve, as well as on the other ten counts for which he was convicted. See *Barnes* v. *United States*, 412 U.S. 837, 848, n. 16.

In any event, petitioner Walker's contention (Pet. 14-15) that the court of appeals "has announced a new double jeopardy test" at variance with *Gavieres* v. *United States*, 220 U.S. 338, upon which petitioner relies, is unfounded. The court of appeals (Pet. App. A13) explicitly relied upon the standard set forth in *Gavieres*—that each statute allegedly violated requires proof of a fact that the others do not. See also *Blockburger* v. *United States*, 284 U.S. 299, 304. The question whether the court of appeals properly applied that test to the particular facts of this case is not one of general importance warranting review by this Court.[10]

3. Petitioner Bruce argues that the failure of the court of appeals specifically to address in its opinion certain issues raised on appeal denied him due process. The third

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[10]Section 77q(a) requires proof of an "offer or sale of * * * securities," which Section 1341 does not, while the latter requires that the use of the mails be "for the purpose of executing" a scheme to defraud (cf. *United States* v. *Maze*, No. 72-1168, decided January 8, 1974, slip op. 10), which the former does not. See generally Mathews, *Criminal Prosecutions Under the Federal Securities Laws and Related Statutes; The Nature and Development of SEC Criminal Cases*, 39 Geo. Wash. L. Rev. 901, 921-923 (1971). These distinctions reflect the fact that Sections 77q(a) and 1341 constitute different "regulatory controls devised by Congress as means for dealing with a social evil * * *" (*Gore* v. *United States*, 357 U.S. 386, 389), fraudulent securities transactions in Section 77q(a), and misuse of the mails in Section 1341.

of these proffered issues—whether the district court erred in denying a motion for judgment of acquittal—simply disputes whether the evidence was sufficient to support petitioner Bruce's conviction. This evidence, fully discussed in the opinion of the court of appeals and summarized above, sufficiently supports the district court's guilty verdict. In any event, as to that and the other two issues mentioned,[11] there is no reason to assume that the court of appeals did not consider them, and the failure to address them expressly in its opinion did not deny petitioner due process. See *Taylor* v. *McKeithen*, 407 U.S. 191, 194, n. 4.

It is therefore respectfully submitted that the petitions for writs of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

AUGUST 1974.

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[11]First, petitioner Bruce contends that a government witness who testified as to generally accepted accounting procedures was not qualified. To the contrary, the witness, George Callahan, had engaged in private practice for two years, had worked with the Internal Revenue Service for nine years, was currently Chief Regional Accountant for the Securities and Exchange Commission, was a certified public accountant, and currently spent approximately 60 percent of his working time on accounting matters (Tr. V 33-34). Secondly, it is contended it was improper for the prosecutor to elicit from petitioner Bruce during cross-examination that he had been decertified in an unrelated case. However, on direct examination petitioner Bruce had testified as to his professional licensing, and represented himself as being a C.P.A. cognizant of currently accepted accounting techniques The questioning of him as to this matter was thus within the proper scope of the government's cross-examination (Tr. VI 143-149).